No. 9579.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

COAST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LOS ANGELES, a corporation,

Appellant,

vs.

R. M. CRAWFORD, Trustee in Bankruptcy of the Estates of Maxfield-Wilton & Associates, Inc., a corporation, debtor, Residential Income Properties, Inc., a corporation, subsidiary debtor, and Wilton-Maxfield Management Company, a corporation, subsidiary debtor; MAXFIELD-WILTON & ASSOCIATES, INC., RESIDENTIAL INCOME PROPERTIES, and WILTON-MAXFIELD MANAGEMENT COMPANY, and SECURITIES AND EXCHANGE COMMISSION,

Appellees.

APPELLANT'S OPENING BRIEF.

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Statement of Pleadings and Facts Disclosing Basis of Jurisdiction.

Reference is made to the agreed statement of counsel [Clk. Tr. p. 2 *et seq.*] filed pursuant to Rule 76 of Rules of Civil Procedure, wherein it is disclosed that the debtor and subsidiary debtors filed in the District Court of the

United States in and for the District of Nevada petitions for relief under Section 77-B of the Bankruptcy Act and that orders granting the same were made on August 11, 1938, and August 22, 1938, respectively; that on September 26, 1938, said proceedings were duly transferred to the District Court of the United States for the Southern District of California, Central Division; that on November 2, 1938, R. M. Crawford and E. K. Hoak were, by order of Court, appointed trustees of said debtor and subsidiary debtors, and that on June 10, 1939, the Court made its order continuing R. M. Crawford as sole trustee; that on December 28, 1938, the Court ordered that all proofs of debt against debtor and subsidiary debtors be filed with the trustees on or before February 13, 1939; that on February 20, 1939, the District Court made an order of general reference referring all matters in said case to Honorable Benno M. Brink, referee in bankruptcy of said Court; that on February 10, 1939, appellant filed with trustees its proof of debt [Clk. Tr. pp. 4 to 13] for the sum of $5754.33, together with interest at the rate of six per cent (6%) per annum from June 15, 1938, together with attorney's fees and costs; that objections to appellant's claim [Clk. Tr. pp. 15-16] were filed by trustee on October 9, 1939, and said objections came up for hearing before said Referee Brink, who, on February 28, 1940, made his order disallowing said debt. That said agreed statement further discloses that on March 7, 1940 [Clk. Tr. p. 51], within the time set forth in Section 39-C of the Bankruptcy Act, appellant filed with said referee its petition for review; that said referee duly filed with the Court his certificate of petition for review; that on April 18, 1940, following the hearing, the Court made an order confirming and approving the order of said

referee, which order was entered upon the minutes on April 18, 1940 [Clk. Tr. p. 55]; that on April 26, 1940, appellant filed its notice of appeal [Clk. Tr. pp. 55-56]; subsequently, by stipulation and orders [Clk. Tr. pp. 60 to 63], the time for filing record of appeal and docketing the action was extended to July 25, 1940, and said record of appeal was filed and docketed on July 25, 1940 [Clk. Tr. p. 64].

Pursuant to Section 121 of the Bankruptcy Statute of 1938, which refers, in turn, to Section 24, Subsections (a) and (b) of said statute, it is submitted that this Court has jurisdiction to review the order appealed from.

Statement of the Case.

Subsidiary debtor arranged through a "dummy" to purchase a parcel of real estate from appellant and said "dummy" gave to appellant his note as part payment of the purchase price. Subsidiary debtor guaranteed payment of said note on the back thereof, waiving protest and notice of protest. The note was secured by a deed of trust upon the purchased property. Some payments upon said note were made, all by subsidiary debtor, but said note became delinquent and appellant caused a notice of default under said deed of trust to be recorded. A few days thereafter subsidiary debtor filed its petition for relief under Section 77-B of the Bankruptcy Act and appellant was enjoined from further proceeding with the sale pursuant to the power of sale under said deed of trust. Appellant filed its proof of debt with the trustee appointed for the debtor and subsidiary debtors for the total amount due under said note and deed of trust, together with advances, costs, interest and reasonable attor-

ney's fees, as called for by said note and deed of trust. Subsequently, pursuant to the application of appellant the order restraining the sale under the terms of the deed of trust was set aside and the trustee under said deed of trust duly proceeded to sell said property. At said sale appellant purchased the property for an amount less than the amount of its claim and thereupon gave notice to the trustee of partial payment of said claim. The trustee filed his objections to said claim as reduced and said claim was disallowed by the order of the referee in bankruptcy, which order was affirmed upon petition for review by the District Court.

The questions involved on this appeal are:

First: Whether the subsidiary debtor was, as a matter of law, a guarantor or a maker of the note.

Second: If subsidiary debtor is a guarantor, as contended, do the limitations and restrictions of Sections 580a and 580b of the Code of Civil Procedure of the State of California prevent appellant from recovering the balance due upon the note?

Third: This point is based upon the contention that the highest courts of the State of California have interpreted said Sections 580a and 580b and that the Federal Courts are bound to apply the state law as interpreted.

A fuller discussion of these questions will be raised in the argument. It is to be noted here that while appellant is bound by the actual facts found by the referee the argument will differentiate between the actual facts found and legal conclusions contained in the referee's formal findings of fact.

Specifications of Error.

1. The purported finding of fact that the subsidiary debtor is not indebted, as contained in paragraph I of the findings of fact [Clk. Tr. p. 30] is a general conclusion of law and not a finding of fact and the only finding of fact contained in said paragraph I is that the subsidiary debtor executed its guarantee on August 12, 1937.

2. That the Court erred in sustaining finding of fact as contained in paragraph IV in so far as it relates to fair market value, for the reason that market value of the property at the date of sale was not material. Timely objection was made to the admission of evidence relating to market value [Clk. Tr. p. 36, lines 1-7].

3. That the Court erred in making finding of fact as contained in paragraph V [Clk. Tr. p. 31], for the reason that said finding is not a finding of fact, but a conclusion of law.

4. The Court erred in making finding of fact as contained in paragraph No. VI for the reason that said finding is not a finding of fact, but a conclusion of law, except with reference to the fact that the note was given to secure payment of the balance of the purchase price of real property.

5. That the Court erred in making its finding in paragraph VII [Clk. Tr. p. 32] that Joseph Honey was a "dummy" for the reason that said fact was immaterial. Timely objection was made to the admission of evidence relating to this question [Clk. Tr. p. 36, lines 1-7].

6. Accepting as true the facts found in the findings of fact, but not the conclusions of law, found as facts in the findings of fact, the Court erred in disallowing appellant's claim.

Summary of Argument.

1. Notwithstanding appellant's knowledge that Joseph A. Honey held the bare legal title, the subsidiary debtor is bound by its guaranty contract which it chose to execute, and the court cannot make a new contract for the parties by treating subsidiary debtor as a maker. Subsidiary debtor contracted as a guarantor and must be treated as such.

2. The law of the State of California provides that guarantors of notes secured by deeds of trust are independently liable on the contract of guaranty. Where the proceeds of the purchase price at the trustee's sale is applied in part payment of said note, the obligation of the guarantor is for the difference between the amount of the proceeds and the amount of the indebtedness.

3. An action against a guarantor for such a balance is not an action for a deficiency judgment within the meaning of Sections 580a and 580b of the Code of Civil Procedure of the State of California, and a guarantor cannot restrict or limit its obligation on the guaranty by the limitations or restrictions contained in those sections.

4. This principle of law and interpretation of the phrase "deficiency judgment" found in those sections has been determined by the Supreme Court of the State of California, and all Federal Courts are bound to apply this law and interpretation.

Argument.

1. Disregarding paragraphs II and III of the objections of the trustee [Clk. Tr. p. 15], which objections the referee found to be untrue, we find that the referee sustained the objections upon grounds 1, 4, 5 and 6. Ground 1 is simply a conclusion, for nowhere in referee's findings of fact [Clk. Tr. pp. 30 to 32] does it appear nor was it contended that the indebtedness was in fact paid in money. The objections were sustained, therefore, upon grounds 4 and 5, which are mixed conclusions of law, and upon ground 6, which is a conclusion of law. In essence the referee found as a fact that Joseph Honey signed the note and deed of trust and that Wilton-Maxfield Management Co., formerly known as Wilton-Maxfield-Wright & Co., the subsidiary debtor, signed the guarantee upon the back of the note, but concluded, however, that Honey was acting as a "dummy" for the subsidiary debtor. From this conclusion the referee further concluded that Section 580a of the Code of Civil Procedure of the State of California precluded a deficiency judgment for the reason that the market value of the property was in excess of the amount of the indebtedness. The referee further concluded that Section 580b of the Code of Civil Procedure precluded a deficiency judgment for the reason that the note upon which the claim was based was a purchase money note.

We admit that a deficiency judgment is precluded by Sections 580a and 580b of the Code of Civil Procedure, but we contend that a deficiency judgment necessarily

means a judgment against the maker and we concede that no deficiency judgment may be obtained against the maker. However, we contend that our claim is based upon the obligation of the guarantee, which is something entirely different from a deficiency judgment against a maker.

The referee's findings of fact actually include conclusions of law which are based upon a false premise. That false premise is that the subsidiary debtor is to be treated as if in fact it signed the note and no guarantee was signed at all. Regardless of the purpose of the subsidiary debtor in contracting in the particular manner in which it did, the fact is that the written contract upon which the claim is based is the real contract and is binding upon the subsidiary debtor, and the Court may not now create a new contract for the subsidiary debtor simply because appellant was aware of the fact that the subsidiary debtor, for reasons known to itself, preferred to contract as a guarantor and not as a maker. Once this is established the fallacy of the referee's conclusions is obvious, for it follows that it is necessary to apply the law which is applicable to guarantors and not the law which is applicable to makers of notes in determining this matter.

2. A leading case upon this subject is *Loeb v. Christie*, 6 Cal. (2d) 416, 57 Pac. (2d) 1303, where the plaintiff sued upon an unconditional guarantee of a promissory note secured by deed of trust containing a power of sale which had not been exercised by the plaintiff at the time of the suit. The Supreme Court held that the guarantor's liability might be enforced without first resorting to the

mortgaged security, citing many cases, and said (at page 1304, Pacific citation):

> "Regardless of the necessity for exhausting the security given before resorting to the personal liability of the *maker* of a note, nevertheless an endorser or guarantor may be sued upon his personal liability before and without such action having been taken. * * * Under the authorities above cited the *obligation of the guarantor is separate and independent from that of the principal debtor, and the fund which the latter may have supplied for payment of his own obligation is not necessarily or logically available to the guarantor. * * * The mortgage only affects the remedy against the mortgagor or primary debtor.*" (Italics ours.)

Prior to the enactment of Section 580a, Code of Civil Procedure, the amount for which the guarantor was liable or the amount of the deficiency, for which the maker was liable, where either followed the sale under the powers of the deed of trust, was necessarily the same and was recoverable by an action at law. The balance or deficiency was based upon the difference of the purchase price of the sale and the total indebtedness, and this was true even though the price at the sale might be considered inadequate.

Bock v. Losenkamp, 179 Cal. 674, 179 Pac. 516 (Supreme Court of California);

Bechtel v. Clemmons, 55 Pac. (2d) 531, 12 Cal. App. (2d) 309;

Central National Bank of Oakland v. Bell et al., 54 Pac. (2d) 1107, 5 Cal. (2d) 324 (Supreme Court of California).

Section 580a limited *deficiency judgments*

(i) As to time within three months after the date of sale;

(ii) As to amount to the difference between an appraised value of the indebtedness.

Before the enactment of Section 580b of the Code of Civil Procedure there was no law in the State of California, whether case law or statute or otherwise, differentiating between a purchase money note and deed of trust or any other kind of note secured by deed of trust, and it follows that there was no difference between a guarantee upon a purchase money note secured by deed of trust and a guarantee upon any other note secured by deed of trust.

3. The question then resolves itself as to the meaning of the term "deficiency judgment" as used in Sections 580a and 580b. It follows that if, by the term "deficiency judgement", an action for a balance of an indebtedness against a guarantor is included, then the special provisions of 580a and 580b are applicable in this case, but that if the term "deficiency judgment" does not include an action against a guarantor upon a balance owing, then the restrictions or limitations of Sections 580a and 580b cannot in any way affect such actions.

We submit that these Sections 580a and 580b do not apply to actions against guarantors, for the reason that the term "deficiency judgment" applies only to actions against makers of notes secured by deeds of trust or mortgages after sale under the powers contained in the

deed of trust or foreclosure of the mortgages. This contention is based upon the decision of

> *Bank of America v. Hunter* (1937), 67 Pac. (2d) 99, 8 Cal. (2d) 592 (Supreme Court of California).

In that case an action was brought to recover on a written guarantee given to secure the payment of a promissory note which was also secured by a deed of trust upon real property. The principal defense was the statute of limitations, defendant contending that the three-months provision of C. C. P., Section 580a, and C. C. P., Section 337, barred recovery. It was held that these sections refer only to actions for the recovery of *deficiency judgments as distinguished from the obligations of a guarantor. They do not have any application to an action upon the independent contract of guarantee and do not bar that proceeding.*

In this judgment, at page 102 (Pac.), the Supreme Court said:

> "Section 337 of the Code of Civil Procedure, which prescribes a four-year limitation for the commencement of actions founded on a writing, is relied upon by the defendant as a bar to the action because of the 1933 amendment thereof, which added a proviso in the following words: 'provided that the time within which any action for a money judgment for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage, may be brought shall not extend beyond three months after the time of sale under such deed of trust or mort-

gage.' The claim of the defendant in this regard is based upon the fact that the present action was not commenced until after the lapse of three months from the sale under the deed of trust.

In our opinion an *action against a guarantor, such as the defendant herein, does not fall within the terms of the quoted portion of Section 337, supra.* (Italics ours.) When that section speaks of an action to recover 'the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage,' it refers to the balance *due upon the principal or secured obligation which is ordinarily recoverable by way of action for a deficiency judgment.* This conclusion is supported by the fact that Section 580a of the Code of Civil Procedure, dealing with deficiency judgments after sales under deeds of trust or mortgages, was added to the Code in 1933 (Stat. 1933, p. 1672), at the same session of the Legislature at which Section 337, *supra,* dealing with limitations of actions, was amended by adding thereto the above-quoted proviso which gives rise to the issue now under consideration. *A reading of Section 580a, supra, as added in 1933, discloses that its provisions have to do solely with actions for recovery of deficiency judgments on the principal obligation after sale under trust deed or mortgage, as distinguished from a guarantor's obligation, such as is here involved.* Section 580a, *supra,* reads, in part:

'Complaint in action for deficiency judgment. Whenever a money judgment is sought for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as

security, following the exercise of the power of sale in such deed of trust or mortgage, the plaintiff shall set forth in this complaint. * * *

'Limitation of actions. Any such action (for a deficiency judgment on the principal obligation) must be brought within three months of the time of sale under such deed of trust or mortgage.'

It is immediately apparent that the descriptive language and the time limitation contained in Section 580a, *supra,* which section deals exclusively with actions for recovery of deficiency judgments, are identical with the descriptive language and the time limitation appearing in the proviso added by the same Legislature to Section 337, *supra,* which latter section deals with limitations of actions. With the addition of the former section (580a) to the Code, it was indispensable that a proviso be added to the latter section (337) in order to assure consistency between the two sections, thus conclusively establishing, in our opinion, that the proviso added to Section 337 in 1933 was intended to, and does, prescribe the time within which an action for a deficiency judgment must be commenced and, *contrary to the defendant's contention, has no application to an action of this character based on the independent obligation of a guarantor.*

The judgment is reversed and the cause remanded to the Superior Court for further proceedings in accordance with the views herein expressed." (Italics ours.)

The ratio *decidendi* in this case applies with equal force to Section 580b. The words "deficiency judgment" as used in Section 580b have a technical meaning and relate only to the "deficiency judgment" referred to in Section 580a, where a deficiency is sought after sale by the exer-

cise of the power of sale in a mortgage or deed of trust, and in Section 726, C. C. P., where a deficiency judgment is sought after foreclosure of the mortgage or deed of trust by a court action. The term "deficiency judgment" is to be found nowhere else in the Code and its prohibition under 580b in the case of a purchase money deed of trust necessarily relates to a deficiency judgment which might otherwise have been obtained against the maker under 580a or Section 726. This distinction is shown by the portion of the *Hunter* judgment above quoted, as italicized by us. There is no statutory prohibition against recovery of judgment against a guarantor of a note secured by a mortgage or deed of trust, whether before or after sale, and whether the note was given as the balance of a purchase price of the real property or otherwise.

4. This law concerning actions by holders of notes against guarantors and this interpretation of the words "deficiency judgment", excluding obligations of guarantors from the scope of those words, is settled by the decisions of the Supreme Court of the State of California above cited, and therefore the Federal Courts are bound by this law and interpretation under the rule of *Erie Railroad v. Tompkins,* 304 U. S. 64.

We submit, therefore, that the claim of appellant, reduced after sale to the amount of $2835.44, together with reasonable attorney's fees, should be allowed in this matter and that the costs of these proceedings should be made costs of administration.

Respectfully submitted,

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Attorneys for Appellant.